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In the Supreme Court

OF THE

United States

OCTOBER TERM, 1940

No. 698

JAMES H. JORDAN, J. R. MASON, L. F. ABADIE, GEORGE F. COVELL, and FIRST NATIONAL BANK OF TUSTIN (a corporation),

Petitioners,

vs.

PALO VERDE IRRIGATION DISTRICT, an irrigation district,

Respondent.

PETITION FOR WRIT OF CERTIORARI
to the United States Circuit Court of Appeals
for the Ninth Circuit
and
BRIEF IN SUPPORT THEREOF.

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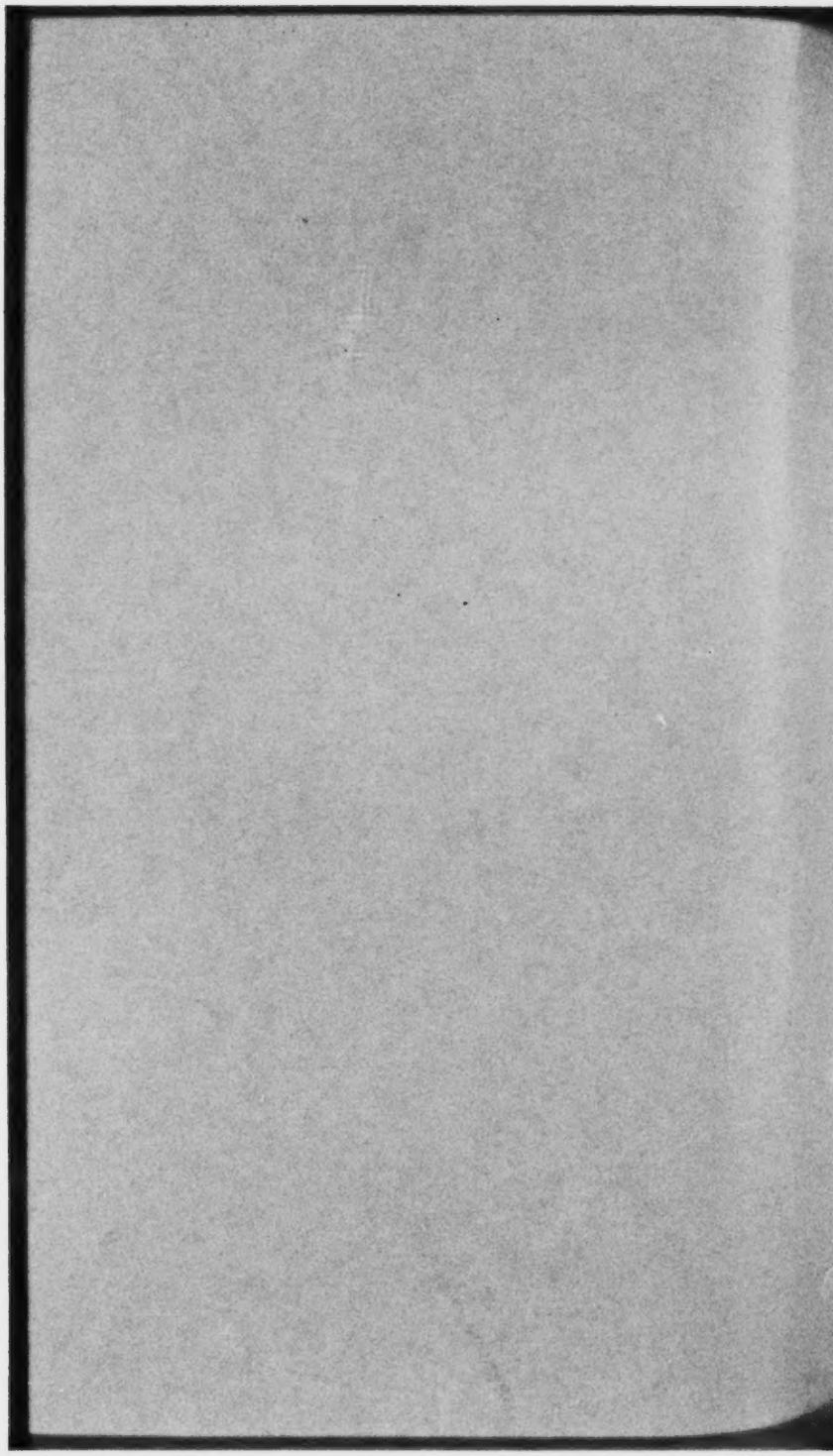

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Petitioners,

vs.

PALO VERDE IRRIGATION DISTRICT, an irrigation district,
Respondent.

PETITION FOR WRIT OF CERTIORARI
to the United States Circuit Court of Appeals for the Ninth Circuit.

To the Honorable Charles Evans Hughes, Chief Justice of the United States, and to the Associate Justices of the Supreme Court of the United States:

Petitioners pray that a writ of certiorari issue to review the decision (R. 378) of the Circuit Court of

Appeals for the Ninth Circuit made in the above entitled cause on September 5, 1940, which affirms the decision of the District Court of the Southern District of California, Northern Division, rendered against petitioners on October 7, 1938. (R. 134.)

OPINIONS BELOW.

No opinion of the trial Court.

Opinion of the Circuit Court of Appeals (R. 379) 114 F. (2d) 691.

JURISDICTION.

The decision of the Circuit Court of Appeals was rendered September 5, 1940. (R. 378.) A petition for rehearing was filed October 4, 1940 (R. 437) and denied October 15, 1940. (R. 437.) The mandate was stayed until disposition of the case by this Court. (R. 437.) The jurisdiction of this Court is invoked under Section 240(a) of the Judicial Code. (28 U. S. C., paragraph 347(a).)

STATUTES INVOLVED.

Municipal Bankruptcy Act of May 24, 1934, Chapter 345 (48 Stat. 798) 11 U. S. C. 301-303, adding Sections 78-80 to the Bankruptcy Act of 1898; Act of August 16, 1937, Chapter 657 (50 Stat. 654) 11 U. S. C. 401-404, adding Sections 81-84; and Act of June 22, 1938, Chapter 575, Section 3(b). (52 Stat. 940.) Important

parts of California Statutes involved are set forth in the appendix.

SUMMARY STATEMENT OF THE MATTER INVOLVED.

This is a proceeding brought by the respondent, Palo Verde Irrigation District, a California irrigation district, organized under the provisions of a special act of the California Legislature, known as the "Palo Verde Irrigation District Act" (Cal. Stats. 1923, p. 1067), under what is now Chapter IX of the Bankruptcy Act of 1898 as amended. (11 U. S. C., 401-404.) The trial Court rendered an interlocutory decree confirming the plan and its decision was affirmed by the Court below.

Statement of facts.

About 1877 Samuel Blythe acquired about 40,000 acres along the Colorado River, which is now part of the Palo Verde Irrigation District. He obtained the first water right upon the Colorado River. In 1908 a private mutual water company was organized. In 1916 it executed a deed of trust conveying its irrigation system in trust to secure a certain bonded indebtedness of which $170,000 are involved in this proceeding.

The Palo Verde Drainage District is a public corporation organized under the provisions of California Statutes 1903, page 291, and it issued certain bonds amounting to $850,000 which are involved in these proceedings.

The Palo Verde Joint Levee District of Riverside and Imperial Counties, California, a public corporation, was organized June 17, 1914 under the provisions of California Statutes 1905, page 327. The district constructed and maintained a levee system along the Colorado River. It issued two issues of bonds. Of the first issue $911,951.86 principal and of the second issue $304,378.50 principal are involved in these proceedings.

The Palo Verde Irrigation District, hereinafter referred to as the "district", was organized in 1923 for the purpose of taking over the functions of the other two districts and the private company. It embraces 95,000 acres of land and is situated in the County of Riverside and overlaps an adjoining county.

Under Sections 12 and 13 of the Palo Verde Act (Appendix pp. ix, xiii) the district assumed the obligation of the bond issues of these other organizations. These sections declared that the drainage district and the levee district ceased to exist "except insofar as may be necessary to preserve the rights of bondholders and other creditors: * * *" The irrigation district itself issued certain bonds. First issue of bonds in the amount of $1,725,000 and the entire second issue amounting to $213,000 are involved in these proceedings. The total principal bond debt involved is $4,174,330.06. (R. 37.)

The petitioners own bonds of all three districts in the total amount of $79,000 principal. (R. 58, 59.) The bond issues all bear interest represented by coupons and the petitioners own the appurtenant

coupons as to their bonds and in addition own some coupons which are detached from other bonds. In 1933 the district applied to the Reconstruction Finance Corporation, hereinafter referred to as "R.F.C.", for a loan under Section 36 of the Emergency Farm Mortgage Act. (Title 43, Section 403 U. S. C.) The loan was granted. (R. 201.) The bondholders deposited their bonds "to or upon order" of the district. (R. 172.) The district ordered the surrender of the bonds and delivery to the R.F.C. (R. 179), and paid the expense of the escrow. These details are important in connection with our contention that the bonds are "controlled" by the alleged bankrupt district and so cannot be counted as votes for the plan of composition under the rule in *American United Life Insurance Co. v. City of Avon Park, Fla.*, 61 S. Ct. 157, ... U. S. ..... (Nov. 25, 1940). The R.F.C. loan was disbursed at 24.81 cents on the dollar principal and nothing for interest. This was all done as to over 90 per cent of the bonds before the first bankruptcy petition was filed in 1935. While the "plan" speaks of 24.81 cents, the private bondholders actually got fifty cents (R. 180, 181) which we claim was discrimination.

On March 29, 1935 the district filed a petition in the United States District Court for the Southern District of California, under Section 80 of the Bankruptcy Act of 1898. (Act of May 24, 1934, Chapter 345, 48 Stat. 798.) The petitioners here appeared in that case (See R. 295—the stipulation concerning these facts). The cause was tried on the merits

and submitted on December 8, 1936. The district judge entered a dismissal of the cause on the grounds of unconstitutionality. (R. 298.) Subsequently the district appealed to the Circuit Court of Appeals which appeal was dismissed. (88 Fed. (2d) 1016.) This is the basis of the claim we make of *res judicata.*

Thereafter certain of the petitioners in December, 1936 obtained an alternative writ of mandate in the Superior Court of Riverside County, California (R. 305) ordering payment of their matured bonds and coupons prior to any payment of any interest to the R.F.C. on its loan made in 1934. This writ is still outstanding.

Thereafter the district filed, in April, 1937, a petition under the Irrigation Districts Refinancing Act (Cal. Stats. 1937, Chap. 24) (part in App. p. i) seeking condemnation of petitioners' bonds under that statute. The statute provides for enforcement of composition plans by condemnation. The same plan of composition (R. 325) was presented to the Court That case was tried and resulted in a decision in favor of the district in April, 1938. On the same day the case of *U. S. v. Bekins,* 304 U. S. 27, 58 S. Ct. 811, was decided, holding the present Chapter IX constitutional. On May 13, 1938 the district filed its petition in bankruptcy in the United States District Court under the present Chapter IX, and subsequently moved to dismiss the condemnation proceedings in the State Court. The question of the dismissal of those proceedings is now on appeal in the State Supreme Court. (R. 149.) The prosecu-

tion of the appeal is enjoined in the District Court. The effect of the pendency of those proceedings is a point in issue here.

The plan of composition has been substantially the same in all three cases (set forth at R. 21) and provides for payment of 24.81 cents per dollar principal and nothing for interest.

The district had been in default upon payment of its indebtedness since 1927, and by 1932 had acquired title to 99.21 per cent of all the lands in the district (R. 258) and which it holds free of taxation by other state agencies. The land, assessed for $3,000,000 in 1937 (R. 25) is worth more than twice the amount offered the bondholders. (R. 295.)

Our view of the case.

Important and difficult questions are involved in these proceedings. While this district was not organized under the California Irrigation District Act it is of like nature to the one involved in the case of *U. S. v. Bekins.* The California Supreme Court has held that the functions of such districts are exclusively governmental and the petitioners seek consideration of the question whether Chapter IX now applies to districts such as this one.

As pointed out, the creation of this district imposed the liability of the former agencies upon the Palo Verde Irrigation District, and the question remains open whether Sections 12 and 13 of the Act (Appendix p. ix) do not have the effect of continu-

ing the liability of the former districts although the liability of the Palo Verde Irrigation District may be annulled in these proceedings. There is also the vital matter of the effect of ownership by this district of all of the lands within its boundaries.

Who in the social system is the beneficiary of such a bankruptcy plan where the district has taken title to all the land and holds it in trust not only for the performance of the public functions of the district, but also for the payment of the indebtedness? *Provident Land Corporation v. Zumwalt,* 12 Cal. (2d) 365, 85 Pac. (2d) 116. There are no beneficiaries to save. The landowners have disappeared. There is no social order to disrupt. Why should this land be cleared of debt for speculators at the expense of the creditors who have been for thirteen years without income from their investment?

This district goes to the R.F.C. and obtains a loan from the R.F.C. on the security of the lands of the district. The lands obviously had value over and above the loan. It may be best for the general welfare of the people of the state that landowners should not be dispossessed of their property en masse, yet here that has already occurred and new landowners have to be sought and obtained. Perhaps many of these are mere land speculators. Why then should this property be turned back to the district to be disposed of by the district and perhaps given away? Why should it not be held in trust for the bondholders so that all proceeds from future sales

should go to the bondholders? Why not a composition plan which would give the bondholders not only the proceeds of the loan, but also the land subject to the loan?

There is another aspect of the situation and that is that the state, having authorized issuance of these bonds, is really the debtor. These bonds bear the great seal of the state. They are state obligations, payable out of assessments against a certain geographical area. The state is the debtor. Now the state steps in and acquires title to the property. Therefore is this situation not really one where the state itself is the bankrupt? How can the state thus relieve itself of debt through bankruptcy?

The district judge, after hearing the first case on the merits, entered a decree dismissing the cause. It would therefore seem to be an adjudication not only on the question of constitutionality as applied to these bonds, but also on the question of fairness or any other issue that was or could have been raised in the case. This Court has held under the former Section 80 which was declared unconstitutional in the case of *Ashton v. Cameron County Water Improvement District No. 1,* 298 U. S. 513, 56 S. Ct. 892, that where bondholders fail to raise their defense, the judgment rendered is binding upon them in spite of the holding of unconstitutionality in the *Ashton* case.

Chicot County Drainage District v. Baxter State Bank, 308 U. S. 371.

The Court below held that certain points on appeal "were not urged in the trial Court". (114 Fed. (2d) 694.) This is assigned as error.

This case had been tried under the former Chapter IX before the same trial judge. A second hearing was had in the State Superior Court under Cal. Stat. 1937, Chapter 24, and it was stipulated that the transcript in the Superior Court be filed in the District Court in lieu of re-examining the witnesses. This stipulation said "That a transcript containing all oral evidence introduced, all objections and rulings thereon and all stipulations made at the trial held in the Supreme Court * * * may be offered in evidence * * * subject to all proper exceptions and objections other than that the witnesses were not produced in Court nor sooner nor testified orally." (R. 46, 47.)

In view of Judge Cosgrave's familiarity with the facts, the petitioners (respondents in the District Court) only presented three preliminary questions to the Court, the question of *res judicata,* the question of the action pending in the State Court, and the question whether the plan was executed out of Court. Obviously these were the only three questions which had not been considered at the first trial under Section 80 or at the trial in the Superior Court. The record went in subject to all of the pleadings (R. 147) and the objections that have been made in the State Court. The record will show, as detailed in our brief that all assigned errors were properly presented to the trial Court. Therefore in view of the fact that the

statute makes the requirement of the Court that it determine fairness of the composition plan, as well as determining other matters as provided in Section 83(e) of the Bankruptcy Act, and relying upon the rule that the Court must form its own independent judgment, petitioners will contend that the Court below erred in its opinion, stating some of the errors assigned had been urged upon the trial Court.

Petitioners will discuss in some further detail in the annexed brief certain other facts pertaining to this case.

Pertinent sections of the California statutes are set out in the Appendix.

QUESTIONS PRESENTED.

(1) We contend that the Palo Verde Irrigation District is a legislative mandatory of the State of California and that no decree of any character issued by a bankruptcy Court can be binding upon it, and that the decree here, although based upon the statute, interferes with the sovereign powers of the State, e. g., power of taxation, and that is true although this Court has held Chapter IX constitutional.

(2) Where an action is pending under a state insolvency law for condemnation of these bonds, if the statute is constitutional, is not such bankruptcy jurisdiction ousted, especially where the state law says that the State Court shall have exclusive jurisdiction of the matters involved? Furthermore, where this statute provides that the filing of an acceptance of the plan of readjustment in the State Court shall be binding upon the accepting creditors

and the district, regardless of subsequent dismissal of the proceedings, does not that constitute a contract which is binding in the Federal Bankruptcy Court?

(3) We contend that when a composition plan has been submitted to the Court after a full hearing and the Court has adjudged that that plan cannot be imposed upon objecting bondholders, that the cause is *res judicata* and the same Court cannot in a subsequent proceeding adjudge the plan to be binding upon the same objecting bondholders.

(4) Where the district itself contributed to the purchase price of the bonds taken over by the R.F.C. and the former bondholders have surrendered all of their interest in the bonds, and accepted the plan of composition, and the R.F.C. is to receive by the composition plan dollar for dollar which is paid for the bonds, can the consent of the R.F.C. be counted as representing an interest adversely affected by the plan? As not "controlled" by the district?

(5) We contend when creditors have accepted a plan of composition under a state statute which declares that such acceptance is binding, the plan has been executed out of Court as to such creditors.

(6) We contend that where some bonds are secured by the power of taxation on personal property as well as real property they are in a different class from the bonds taxable solely against real property. We contend that a writ of mandate impounding funds for certain creditors creates a right to separate classification.

(7) Where the plan on its face purports to allow 24.81 cents on the dollar of principal for each bond-

holder, but in point of fact holders of $170,000 have been paid fifty cents on the dollar, is not the plan discriminatory where as here the bonds paid at 50¢ have no priority over the other bonds?

(8) We contend that the rule of the Boyd case (*Northern Pacific Ry. Co. v. Boyd,* 228 U. S. 482, 33 S. Ct. 554) should be applied in municipal bankruptcy proceedings and this Court should so determine and that as applied here the cause should be reversed because the trust assets are greatly in excess of the debts.

(9) Where the public corporation has taken title to over 99 per cent of the lands in the district is a plan of composition fair which does not give these lands to the creditors in addition to the amount borrowed on them from a banker? We contend that there is no social or political reason justifying the taking of the land from the bondholders and giving it to speculators or even bona fide settlers, but that it should be conveyed to the bondholders in addition to giving the bondholders the benefit of the loan from the R.F.C. Furthermore, we contend that where the state has acquired through its agencies the title to all this property that to extend bankruptcy to such an agency amounts to extending bankruptcy to the state itself since the property is state owned and the agency a mere alter ego of the state. We contend further that all of such property is held in trust for the bondholders and the substantial amount of funds on hand and the lands of the district and all other trust properties are property which cannot be administered by a Bankruptcy Court, and that

the state cannot confer upon the Bankruptcy Court power to administer these trusts.

(10) The plan of composition is not proposed or accepted in good faith where the debtor has control of the securities affected, where it has contributed to the purchase thereof by the R.F.C., where it has connived at the execution of a contract not authorized by the electors, and where the R.F.C. is virtually its fiscal agent.

(11) Where the public agency was organized for the purpose of taking over the obligations of a private corporation and two public agencies, and those two public agencies were continued in existence "to preserve the rights of bondholders" does a composition proceeding to which only the public corporation which took over the liabilities of the others, is a party, discharge the debts of these other corporations?

(12) We contend that under the facts of this case stated above where the objections and points were pleaded, the case was tried upon the theory of the objections that were made, and the statute requires the Court to determine the very questions which we have raised, that a creditor can appeal and rely upon such objections and that this Court should so determine.

REASONS FOR GRANTING THE WRIT.

1. We submit that no judgment of the bankruptcy Court can extend to this district since its functions are exclusively governmental. This Court should determine that inasmuch as the statute declares that there

shall be no interference by decree or otherwise with governmental powers, that no decree of the bankruptcy Court can be binding upon this district nor could interfere with the right of the landowner or a creditor to mandamus the district to perform the duties imposed upon it by law with respect to taxation or other fiscal or governmental functions. This Court also should determine whether the provisions of the act, prohibiting interference with governmental powers does not void the decree here which in effect adjudicates that the district shall not pay its creditors in full, nor levy taxes, except in accordance with the plan, shall not issue further bond issues, shall not make any levy of tax without consulting the R.F.C., shall report to that agency and otherwise come under its control. We submit that the ability of a tract of land to pay taxes can not be adjudged by the bankruptcy Court to be the measure of the power of the state to levy taxes.

2. We submit that this Court should determine that this cause is *res judicata* by reason of the former adjudication of the same plan under the first municipal bankruptcy act, and that this question is of public importance and is undetermined and should be set at rest since the question may reoccur.

3. This Court ought to determine, we respectfully submit, that the R.F.C. cannot have its vote for the plan of composition counted where the district has contributed, however slightly to the purchase of the bonds, where the original bondholders have surrendered all of their interest in those bonds, and the R.F.C. is to receive dollar for dollar paid out in the purchase of the bonds. Such interest is not adversely

affected. This is a question of general public importance since the R.F.C. has advanced loans to many agencies throughout the nation.

4. We submit that where an action is pending under state insolvency law, which has not been declared unconstitutional, for condemnation of the bonds and where the statute provides that the local Court shall have exclusive jurisdiction, that the federal Court cannot take jurisdiction of such a cause; and furthermore we submit that the Court should determine that where the statute provides that giving of consent under the state law is binding upon the accepting creditors and the district, that becomes a contract which cannot be annulled under a bankruptcy proceeding. This is a question not previously determined by this Court.

5. We submit this Court should determine that regardless of whether the district involved has matured obligations which it cannot presently pay, a plan cannot be fair which seeks to pay less than the amount of the principal where the assets exceed the debts. Further this Court ought to determine that where there are no remaining landowners, i. e., stockholders or equity holders, the creditors should get all the assets.

6. Where a plan of composition offers 24.81¢ per dollar of principal to all creditors and the Court finds they are all of the same class, but $170,000 of claims were actually paid 50¢ on the dollar this Court should declare such a plan discriminatory as we contend.

7. The Court should determine, we submit, that a plan of composition is not accepted in good faith

where the securities are virtually "controlled" by the debtor, which has contributed to the purchase thereof, and that the same principles of law which apply to the relations between private citizens should be applied between the R.F.C. and the public debtor.

8. This Court ought to determine that where a public trust has been created the bankruptcy Court cannot administer that trust or make any decree concerning its administration.

9. This Court should determine, we submit, that where creditors in the bankruptcy proceeding have appeared, filed pleadings and made their objections known to the Court, and where, furthermore, the statute requires findings upon special and distinct issues, it is proper for such objecting creditors in an appeal to assign disallowance of those objections as error.

These matters are of great importance as affecting the proper administration of the Municipal Bankruptcy Law. The lower Courts, we feel, have been prone to confirm any plan of composition presented by a public agency, without as in this case, applying the rules of law which would be applied in the case of a private debtor. There is no special sanctity in the arrangements of public corporations. Public officials often display a far greater disregard of the principles of common honesty in conducting public business than they would in conducting their own private business. This Court should, we respectfully submit, lay down the rules which should prevail in the administration of this new field of bankruptcy law.

Wherefore, petitioners pray that a writ of certiorari be issued out of and under the seal of this Honorable Court, directed to the United States Circuit Court of Appeals for the Ninth Circuit, commanding that Court to certify and to send to this Court for its review and determination a full and complete transcript of the record and of the proceedings of said Court in the case numbered and entitled in its dockets as "No. 9133, James H. Jordan, J. R. Mason, L. F. Abadie, George F. Covell, and First National Bank of Tustin, a corporation, Appellants, v. Palo Verde Irrigation District, an irrigation District, Appellee", and that the decree of said Court be reversed by this Court with directions to dismiss the proceeding, and for such other relief as to this Court may seem proper.

Dated, Turlock, California,
January 6, 1941.

James H. Jordan,
J. R. Mason,
L. F. Abadie,
George F. Covell,
First National Bank of Tustin
(a corporation),

Petitioners.

W. COBURN COOK,
Counsel for Petitioners.